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VIA E-MAIL – regcomments@ncua.gov

[redacted]

April 6, 2009

Ms. Mary F. Rupp
Secretary of the Board
National Credit Union Administration
[redacted]

RE: CUNA's Comments on Advanced Notice of Proposed Rulemaking for Part 704, Corporate Credit Unions

[redacted]

On behalf of the Credit Union National Association, we are filing this letter with the National Credit Union Administration to address the future of the corporate credit union system, in response to NCUA's Advance Notice of Proposed Rulemaking (ANPR) on the corporate credit unions. By way of background, CUNA is the largest credit union advocacy organization in this country, representing approximately 90% of our nation's 8,000 state and federal credit unions, which serve 92 million members.

This letter was developed under the auspices of CUNA's Corporate Credit Union Task Force (CCUTF), which is chaired by Terry West, President and CEO of VyStar Credit Union in Jacksonville, FL. The other members of the Task Force are: Robert Allen, President and CEO of Teachers FCU in Farmingville, NY; Dale Dalbey, President and CEO of Mutual Savings Credit Union in Birmingham, AL; Tom Gaines, President and CEO of the Tennessee Credit Union League; Frank Michael, President and CEO of Allied Credit Union in Stockton, CA; David Rhamy, President and CEO of Silver State Schools CU in Las Vegas, NV; and Jane Watkins, President and CEO of Virginia Credit Union in Richmond, VA. Kris Mecham, CUNA Chairman and President and CEO of Deseret First FCU in Salt Lake City, UT; Tom Dorety, Immediate Past CUNA Chairman and President and CEO of Suncoast Schools FCU in Tampa, FL; and Harriet May, CUNA Vice Chairman and President and CEO of GECU in El Paso, TX, serve as ex officio members.

While the restructuring of the corporate credit union system is very significant, most federally insured credit unions have been focused on, and are extremely concerned about, the costs they must bear in connection with the National Credit Union Share Insurance Fund's (NCUSIF) assistance for corporate credit unions.

These include the write down and replenishment of their 1% NCUSIF deposit, their insurance premium costs, and the impairment of their capital in their corporate credit unions that many credit unions must reflect. This letter addresses both the immediate issues related to NCUA's recent actions on corporate credit unions and the longer-term restructuring questions, beginning with a summary of the issues and our responses.

I. Summary of CUNA's Views

A. Costs of NCUA's Assistance for Corporate CUs

- The costs associated with the NCUSIF's assistance to the corporate credit unions, along with the impairment of credit unions' capital in their corporate credit union, will have a deleterious impact on the credit union system if they must be absorbed in one year.
- CUNA and the Corporate Credit Union Task Force have urged NCUA since January 28th, when it announced the NCUA Corporate Credit Union Stabilization Plan, to provide a mechanism to allow credit unions to spread out their costs, as the Federal Deposit Insurance Corporation (FDIC) has done for banks. Most in the credit union system feel the Board should not have announced the Corporate Stabilization Plan in January without having developed a mechanism to spread out the costs to credit unions.
- CUNA will continue to do all we can to attain a better outcome for credit unions than the current situation, including through assistance from the U.S. Treasury
- However, CUNA strongly commends the Board for its work on its new legislative proposal, which is addressed below, and we want to continue to work with NCUA and others to achieve amendments that will help mitigate the impact of the costs on credit unions.
- We particularly support NCUA's proposal to establish a Stabilization Fund that, if approved by Congress, could borrow from the Treasury to fund assistance to corporate credit unions, which will help spread out the costs to federally insured credit unions.
- NCUA's proposed amendment calls for $6 billion in borrowing authority for the new Stabilization Fund – a figure very close to NCUA's estimated $5.9 billion in insurance costs to fund the assistance to the corporate credit unions. Additional authority for NCUA to borrow up to $18 billion in emergencies, with approval from the Treasury and others, is also pending. CUNA agrees these changes are an improvement over the current $100 million in borrowing authority for the agency. However, we support seeking greater borrowing authority for the NCUSIF or the new Stabilization Fund, to give NCUA and credit unions even more flexibility in dealing with insurance costs, to the extent efforts to pursue higher borrowing authority do not

jeopardize our ability to achieve legislation that will mitigate the impact of the costs on the credit union system

- CUNA also supports statutory amendments that will give credit unions up to eight years to pay for insurance costs.
- In addition, we are advocating an amendment that will allow the Central Liquidity Facility to provide liquidity directly to the corporate credit unions, as another tool to assist NCUA and the credit union system.
- From the time NCUA announced it had contracted with PIMCO to analyze the securities held by corporate credit unions, CUNA has been urging NCUA to provide adequate information to credit unions from the report, particularly the assumptions and analyses regarding losses.
- Credit unions need the information so they can determine the reasonableness of the agency's cost estimates relating to the losses within the corporate credit unions and the resulting insurance assessments to credit unions. These assumptions have an additional negative impact on many credit unions because of the impairment of their capital in their corporate, which will not be addressed by the new legislation.
- Until now, credit unions have had no way to assess the agency's assumptions regarding these costs.
- On April 3, 2009, NCUA Board Chairman Michael Fryzel announced that key information from the PIMCO report will be provided to the members of the two corporate credit unions placed into conservatorship, WesCorp and U.S. Central, and the state regulators. A summary of significant information from the report will be provided to others. He also announced that the two corporate credit unions are each obtaining an independent, third-party assessment of the credit losses for their asset-backed securities.
- CUNA commends this NCUA Board action and wants to continue to work with NCUA to achieve transparency regarding the agency's corporate credit union actions to the fullest extent possible and appropriate. This includes providing sufficient information regarding the PIMCO report and other key information to the entire credit union system so that credit unions will be able to evaluate whether the agency's credit loss evaluations and the various agency decisions, which were based on those evaluations, are reasonable.
- The actual losses that credit unions will ultimately have to bear from the asset- and mortgage-backed securities in corporate credit union portfolios will depend in large part on those securities being held until they have been largely amortized. While NCUA has indicated it plans to hold the securities to maturity, we believe it is imperative that NCUA take additional steps to assure credit unions that, unless it can work with Treasury to obtain a favorable price well above the current market value for the securities before

they mature, these securities will not be sold prior to almost complete amortization.

- A number of accounting issues have arisen since the announcement of the assistance to the corporate credit unions and the two corporate credit union conservatorships. The issues generally relate to when and to what extent natural person credit unions must report the impairments of their NCUSIF deposits and capital in their corporate credit unions. While credit unions have raised concerns about NCUA's accounting guidance in Accounting Bulletin (AB 09-2) CUNA appreciates the latest agency memorandum to examiners, which indicates credit unions will not be dealt with harshly if they do not report their NCUSIF deposit impairment on their March 31, 2009 statements. CUNA wants to continue working with NCUA to achieve as much clarity for credit unions on these issues as possible.

B. Corporate CU Services

- Corporate credit unions should focus on core services of settlement, payment systems, and meeting the short-term investment and liquidity needs of their member credit unions.
- Long-term investments have created serious problems for the corporate credit union system that natural person credit unions are now having to pay for.
- Corporate credit unions should not be permitted to concentrate their assets in long-term, on-balance sheet investments because such activities have resulted in some corporate credit unions taking on more risk than they could reasonably manage or mitigate.

C. Corporate CU Structure

- The current two-tier corporate system has outlived its utility and characteristics of the system that have facilitated undue risk taking, reduced credit unions' capital, and created inefficiencies must be eliminated.
- Requiring corporate credit unions to focus on payments, settlement and short-term investments and liquidity will reduce the number of corporate credit unions.
- CUNA is not advancing a specific number of corporate credit unions, and it is not recommending that NCUA determine the appropriate number.
- However, the number of corporate credit unions should be small enough to reflect operational efficiencies that benefit natural person credit union members.

- Further, a single interface between the corporate credit union system and key payment and settlement entities could be extremely beneficial as it could combine and strengthen credit unions' ability to influence governmental and private sector decisions in these areas that impact credit unions' operations.
- At the same time, having more than one corporate credit union to provide one or more of the core services for natural person credit unions could prove to be beneficial.
- In any event, the number of corporate credit unions should be sufficient to promote innovation among the remaining corporate credit unions and avoid a potential single point of failure that could arise if only one corporate credit union survives.

D. Capital of Corporate CUs

- Corporate credit unions' Tier 1 capital requirement should be at least 4% and could be as high as 6%. Risk- based capital should also be required.
- Natural person credit unions that use corporate credit unions should be required to maintain contributed capital in their corporate.

E. Corporate Governance

- Corporate credit unions should be permitted to have outside, non-member directors who can contribute diverse experiences to a corporate credit union's board.
- A corporate should be permitted to have up to 20 percent of its board comprised of non-members and also be permitted to pay a non-member director a reasonable director's fee.
- Such fees should be comparable to those paid by federally-insured depository institutions of similar asset size, so long as the amount of this fee and any other director compensation is fully disclosed to the corporate credit union's members.

F. Fields of Membership

- CUNA supports allowing corporate credit unions to have national fields of membership.

II. Discussion of CUNA's Recommendations and Key Points

A. NCUA's Corporate Credit Union Stabilization Program

Few, if any, issues confronting the credit union system are of greater significance than the National Credit Union Administration's handling of the financial predicament that has confronted the corporate credit union system. That is because the economic, political, and member/public relations issues associated with NCUA's decision to place U.S. Central Corporate Federal Credit Union and Western Corporate Federal Credit Union into conservatorship, as well as the NCUSIF assistance to corporate credit unions announced in January which combined are now estimated to cost federally insured credit unions $5.9 billion, will have serious ramifications now and well into the future – particularly if credit unions have to write down these costs all in one year.

While issues relating to the funding of the assistance to the corporate credit unions are not part of the ANPR, our members have urged us to address these matters in the context of this comment letter.

Our members feel strongly that they should be able to spread out as much of their insurance costs as possible over time, particularly in light of the fact that the FDIC determined that a special insurance premium amounting to 20 basis points of insured deposits, on top of the regular 12 to 16 basis point premium, was too much for the banks to fund in one year. Following complaints from the banks, the FDIC reduced this year's special assessment to 10 basis points, for a total of 22 to 26 basis points. – far less than the insurance costs credit unions are expected to pay.

Since January 28, 2009, when NCUA announced the corporate assistance, CUNA and its Corporate Credit Union Task Force have been urging NCUA to adopt alternative approaches for funding the assistance that will help spread out the program's insurance costs to credit unions.[1] As we have discussed with the agency, while some options would take time to implement, in our view NCUA has the legal authority to spread out all premium costs that restore the NCUSIF equity to over 1% of insured shares.[2] NCUA does not need approval from Congress or Treasury to take this action.

We do applaud NCUA's efforts to develop legislation that will help spread out all the insurance costs for credit unions, and we want to work with the agency as well as the National Association of State Credit Union Supervisors, the National Association of Federal Credit Unions, and the National Federation of Community Development Credit Unions to achieve its passage as quickly as possible. In particular, CUNA supports:

- The new proposal developed by NCUA to establish a Stabilization Fund that could borrow from the U.S. Treasury to fund assistance to corporate credit unions; and
- Legislation that will give credit unions up to seven or eight years to pay for insurance costs and increase the authority of the NCUSIF to borrow from the Treasury in exigent circumstances.

NCUA's new proposal calls for $6 billion in borrowing authority for the Stabilization Fund, absent exigent circumstances. This level is very close to the $5.9 billion estimate NCUA has indicated the insurance costs to credit unions will e as a result of the corporate credit union assistance. Pending legislation will allow NCUA to borrow up to another $12 billion from Treasury in emergencies, but only with the approval of Treasury and others. These proposed limits are improvement over the current $100 million borrowing authority, and we appreciate efforts to expand NCUA's borrowing authority. However, we hope to partner with NCUA to pursue even higher borrowing authority for the NCUSIF or the new Stabilization Fund, as long as such efforts will not place the legislation to mitigate the impact of the costs on the credit union system at risk.

We also support an amendment to allow the Central Liquidity Facility to provide short-term loans directly to corporate credit unions, and we would welcome NCUA's support to include this amendment in the Stabilization Fund legislation.

While CUNA commends the Board for its work on this proposal, our members feel the Board should not have announced the assistance for the corporate credit unions without providing an acceptable mechanism to spread out the costs credit unions will bear – particularly given the impact of these costs on credit unions in some areas, which have already been weakened by the current economic crisis.

The decisions NCUA has made this year regarding the corporate credit union system are among the most monumental the agency has ever made and will continue to impact the entire system for years to come. Since NCUA announced it had contracted with PIMCO to analyze the securities held by corporate credit unions, CUNA has been urging NCUA to provide adequate information to credit unions so they could determine the reasonableness of the agency's cost estimates relating to losses within the corporate credit unions and the resulting insurance assessments to credit unions. These assumptions will have an additional negative impact on many credit unions because of the impairment of their capital in their corporate credit unions, which will not be addressed by the new legislation.

Until now, credit unions have had no way to assess the validity of the agency's assumptions regarding these costs. On April 3, 2009, NCUA Board Chairman Michael Fryzel announced that key information from the PIMCO report will be provided to the members of the two corporate credit unions placed into conservatorship, WesCorp and U.S. Central, as well as to the state regulators. A summary of significant information from the report will be provided to others. He also announced that the two corporate credit unions are each obtaining an independent, third-party assessment of the credit losses for their asset-backed securities.

CUNA commends this NCUA Board response and wants to continue to work with NCUA to achieve transparency regarding the agency's corporate credit union actions to the fullest extent possible and appropriate. We are hopeful that sufficient information regarding the PIMCO report will be provided to the entire credit union system so that credit unions will be able to evaluate whether the agency's credit loss evaluations and the various agency decisions, which were based on those evaluations, are reasonable.

The estimate of the costs to the share insurance fund for the Corporate Stabilization Program ($5.9 billion as of this writing) is indeed just that, an estimate. The ultimate losses derived from the portfolio of securities held by the corporate credit unions depends on two factors: the actual credit losses on the securities (determined by various and complicated future economic events), and the extent to which the securities might be sold prior to full amortization, resulting in market losses that could exceed the eventual credit losses.

Credit unions understand that they will eventually be responsible through the share insurance fund for the actual credit losses in the portfolio, and that the extent of these losses is currently unknowable. They are, however, very concerned that they might be forced to pay additional market losses resulting from premature sales of the securities.

Credit unions understand that the agency would not be in a position to sell the securities so long as the market losses exceed the available reserves (including the $5.9 billion added to available funds). Yet they are anxious that once the Fund is "in the money," counting existing capital and the additional $5.9 billion, the pressure on the agency to sell the remaining securities and lock out any future increases in losses could become acute.

NCUA has released a statement and Board members have indicated the agency's intent to hold the securities until maturity, which is positive. However, credit unions continue to seek assurances that the agency will be able to withstand pressure and hold the securities until they are largely amortized or essentially back to par, unless it is able to work with the Treasury to sell corporate credit unions' assets before they mature at favorable prices well above their current market values.

Finally, a number of accounting issues have arisen since the announcement of the assistance to the corporate credit unions and the two corporate credit union conservatorships. These relate to when and to what extent natural person credit unions must report the impairments of their NCUSIF deposit and capital in their corporate credit unions. These are not easy issues and questions remain concerning appropriate accounting treatments. The latest agency memorandum to examiners indicates credit unions will not be dealt with harshly if they do not report their NCUSIF deposit impairment on their March 31, 2009 statements. CUNA appreciates this development and wants to continue working with NCUA to achieve as much clarity for credit unions on these accounting issues as possible in a timely fashion.

B. CUNA's Corporate Credit Union Task Force

Prior to NCUA's issuance of the ANPR, in recognition of the serious issues facing corporate credit unions, CUNA formed the Corporate Credit Union Task Force (CCUTF) earlier this year.[3] The CCUTF has met a number of times to consider the issues outlined in the ANPR. The role of the Task Force has been to review the current corporate credit union network, assess the nature and scope of the problems within the network, and to develop forward thinking, feasible recommendations to address those problems responsibly.

A key objective for the Task Force in crafting its recommendations for reform of the corporate system has been to ensure the interests and needs of natural person credit unions for payment and settlement services as well as short-term liquidity are met. The Task Force also sought to develop recommendations that would mitigate the risks associated with corporate credit union operations. This letter reflects their views, as well as those of numerous credit unions and Leagues that responded to this request for comments. It has also been reviewed by CUNA's Governmental Affairs Committee as well as our Board of Directors, and it represents CUNA's official positions. CUNA's GAC and Board reflect a broad cross-section of American's credit unions by size, region, and charter types.

C. The Future Structure of the Corporate System

CUNA is aware that the first task the Board must deal with regarding corporate credit unions is stabilizing the system in the near-term. Once that has been accomplished, a transition to a revised system will be necessary. In our comments that follow, we deal only with what the optimal system should be, not with the mechanism of how to transform the current system to its future form.

Corporate credit unions have historically fulfilled an important role by providing natural person credit unions with settlement and payment services. In addition, corporate credit unions have played a major role in meeting both the short- and long-term investment needs of credit unions, and in providing short- and medium-term loans to credit unions.

As a result of the current economic crisis, many corporate credit unions have experienced a dramatic reduction in the market value of their investments. These reductions have been exacerbated by the virtual shutdown of the market for mortgage-backed securities and other investments. This series of events has severely undermined the stability of the corporate credit union system.

CUNA believes that the future structure of the corporate credit union system must be very different from the one that has evolved over the past three decades, if it is going to be well positioned to meet the needs of member credit unions while successfully managing risk. Changes must be made to the number of tiers within the system, the number of corporate credit unions, the services they provide, their capitalization, and governance. Ultimately, the driving factor must be the set of services that it is essential for credit unions to receive from a corporate system. Once those services are established, the remaining issues concerning the future of the corporate system can be determined.

D. Services Provided by the Restructured Corporate System

Services currently provided by corporate credit unions can be divided into the following mutually exclusive categories:

- Payment processing, such as checks, ACH, Wire Transfers, ATM and debit, etc. Payment processing involves transferring information about financial transactions (payments) so that the financial institutions of both the payor and payee know when to debit or credit whose account by how much. In addition to corporate credit unions, a number of other vendors provide various types of payment processing to credit unions.

- Settlement. This function involves transferring money among financial institutions to settle out the net effect of inflows and outflows resulting from payments and other credit union transactions. Settlement requires a financial institution charter, and maintaining accounts at a Federal Reserve Bank and other financial institutions to execute and manage the transfer of funds.

- Short-term investments. This function involves investments credit unions make with overnight funds, and other short-term investments. The limit for short-term investments could be as short as three months, but no longer than one year.

- Short-term liquidity. This function involves providing short-term lending to credit unions. This could be for as short as overnight to facilitate a credit union’s settlement accounts, to slightly longer to allow credit unions to adjust to monthly or seasonal liquidity flows.

- Long-term investing. This involves portfolio investing for credit unions with longer maturities than defined as short-term investing.

- Long-term liquidity. This involves longer term lending to credit unions. Credit unions typically undertake such borrowing not to adjust to net loan and savings inflows, but instead for asset/liability management purposes such as holding longer term loans.

Among these services, **<u>the</u>** core function that credit unions require from a corporate credit union system is settlement. Settlement provides the point of contact of the credit union movement with the rest of the financial system, and we believe that credit unions would be placed at a significant disadvantage if they had to individually arrange for settlement services with correspondent or Federal Reserve banks. Settlement is a function that can be performed efficiently at scale by a very few endpoints for the entire credit union system.

Whatever institution provides settlement services must also be able to provide short-term investing and liquidity. A credit union's settlement account is its overnight, interest-earning account. Access to overnight or very short-term loans is also necessary for settlement.

These then comprise the core functions that the future corporate system must be designed to offer: settlement, short-term investments, and short-term liquidity.

Payment processing is often linked to settlement and short-term liquidity and investment, and there can be efficiencies in a corporate credit union offering various types of payment processing. CUNA supports payment processing as a permissible activity for corporate credit unions because it is often so closely related to settlement.

E. Long-Term Investments and Concentrations in Such Investments for Corporate Credit Unions Should Be Curtailed and Managed

Many believe that, in the future, corporate credit unions should not be engaged in longer-term investing (on the corporate credit union's balance sheet). Long-term investments and liquidity are not crucial to the settlement function, and longer-term investing has been the source of most of the serious problems in the corporate system, such as the failure of CapCorp and the current problem of unrealized losses on illiquid securities. Corporate credit unions could in theory successfully and safely engage in providing term investment services on their own balance sheets, but permissible investment activities would need to be more restrictive than current regulations, and corporate credit unions would have to be required to hold capital levels far in excess of what credit unions would likely be willing to provide. A number of credit unions believe there is not enough capital in the credit union movement to fund long-term investments on the balance sheets of both natural person and corporate credit unions. Another consideration in removing long-term investing from corporate credit unions is the fact that it is feasible for credit unions to meet their long-term investing needs through means already available outside corporate credit union balance sheets: securities purchases, mutual funds, investment advisory services, and deposits in other financial institutions.

Corporate credit unions have traditionally held relatively broad authority to engage in long-term (greater than one year) investing. Absent such authority, corporate credit unions likely would not have been able to obtain the favorable yields they have been able to garner and pass on to their member credit unions. Obtaining such yields, however, has not been without substantial risk for the corporate credit union system. Furthermore, as the system is currently structured, losses stemming from these long-term investments can have a direct, detrimental affect on natural person credit unions and on other aspects of the corporate credit unions' operations, including payment, settlement, and liquidity services.

Part 12 C. F. R. 704.5(c), Investments, of NCUA's Rules and Regulations, describes corporate credit unions' current basic investment activities, which CUNA supports for corporate credit unions going forward. These include investments in:

- Securities, deposits, and obligations set fort in Sections 107(7), 107(8), and 107(15) of the Federal Credit Union Act;
- Deposits in, the sale of federal funds to, and debt obligations of corporate credit unions, Section 107(8) institutions, and state banks, trust companies, and certain mutual savings banks;
- Corporate CUSOs;
- Marketable debt obligations of certain corporations; and
- Domestically-issued asset-backed securities.

Additionally, Appendix B to Part 704, Expanded Authorities and Requirements, details the riskier investments that qualifying corporate credit unions can purchase, such as long-term investments rated no lower than BBB. NCUA attempts, in Appendix B, to mitigate the risk involved with these investments by mandating that participating corporate credit unions fulfill "additional management, infrastructure, and asset and liability requirements." Corporate credit unions seeking to purchase long-term, Appendix B investments must first be granted prior approval—which can subsequently be removed at any time—by NCUA.

Even with the above-mentioned safeguards, the risk to the entire credit union system associated with certain short-term investments, such as asset-backed securities, and long-term investments in Appendix B may be too great. The possible long-term investments enumerated under the appendix include those that have resulted in much of the corporate credit unions' unrealized losses and other-than-temporarily impaired assets.

However, while removing the authority to invest in riskier long-term investments will reduce the risk to the entire credit union system, such limitations will also have the consequence of reducing the earning potential of natural person credit unions. Many of these credit unions have already been heavily invested in their corporate credit unions.

In light of these concerns about investments and concentrations of assets in a limited number of investment vehicles, CUNA encourages NCUA to consider the extent to which longer-term, riskier investments for corporate credit unions should be dramatically curtailed and whether alternative means for natural person credit unions to invest in some additional investments should be pursued.

To be clear, CUNA encourages NCUA to consider supporting natural person, not corporate, credit unions to have the option to purchase alternative investments vehicles, such as those authorized under the proposed Credit Union Regulatory Improvement Act (CURIA). Section 301, Investments in Securities by FCUs, of CURIA, for example, would authorize the Board to permit natural person credit unions to purchase certain investment securities as the Board sees appropriate. Allowing natural person credit unions to make such investments through providers outside the credit union system would have the effect of moving some of the risk away from the National Credit Union Share Insurance Fund (NCUSIF). Any investment losses suffered by natural person credit unions would affect the NCUSIF only if they substantially reduce the credit unions' net worth, and even then might be covered by FDIC insurance if the investment provider were a federally insured bank.

F. The Number of Corporate Credit Unions and Their Tiers

Once the primary function of corporate credit unions has been determined to be the provision of settlement services and closely related activities, the issue of the appropriate number of corporate credit unions can be addressed. Processing payments and handing settlement are scale businesses, so the number of corporate credit unions can be sharply reduced to a very small number. With only a few, large corporate credit unions serving natural person credit unions, there would no longer be the need for a two-tiered structure.

Achieving economies of scale and enhancing the ability of the credit union system to influence and interface with the settlement process supports a good case for having only one corporate credit union. Under this approach, the remaining corporate credit union would serve as the settlement gateway from the entire credit union movement to the rest of the financial system on settlement and related issues. The principles and recommendations outlined in this letter would not preclude that outcome.

However, economies of scale are not the only considerations regarding the number of corporate credit unions into the future. Beneficial effects on pricing and innovation are also needed, which may be harder to attain without some direct credit union-market competition.

In any event, CUNA does not support having NCUA determine the appropriate number of corporate credit unions. Rather, we believe that as a result of capital requirements and limits on services and investments, member credit union owners should contemplate no more than a very limited number of corporate credit unions – small enough to take advantage of economies of scale, but large enough to foster innovation and competition.

G. Corporate Credit Union Capital

CUNA believes that a corporate credit union's minimum Tier 1 capital ratio should be at least 4 percent and possibly higher, up to 6 percent over a reasonable period of time. If NCUA chooses to institute risk-based capital requirements for corporate credit unions, such risk-based capital should be comparable to those applicable to similarly situated FDIC-insured depository institutions. CUNA believes that market factors, such as corporate credit unions' payments system counterparties' concerns about counterparty risk, will generally encourage corporate credit unions to maintain higher net worth ratios of up to 6 percent.

CUNA believes, however, that risk-based capital requirements are likely unnecessary for corporate credit unions if NCUA adopts CUNA's recommendations for limitations on corporate credit unions' business and investment activities, as outlined above. CUNA believes that if NCUA has concerns regarding the amount of capital necessary to cover corporate credit unions' payment and settlement risks, it should consider requiring a payment and settlement risk reserve that would be deducted from Tier 1 capital but included in Tier 2 capital to some degree, as discussed below under "4."

1. Components of Corporate Credit Union Capital and Capital Ratios

CUNA believes that a corporate credit union's regulatory capital should consist of Tier 1 capital—reserves and undivided earnings (RUDE) as well as paid-in capital (PIC)—and Tier 2 capital. Corporate credit union Tier 2 capital should include member capital shares (MCS) as well as subordinated term debt and general reserves such as the "Reserve for Payment and Settlement Risk" discussed below.

CUNA also believes that Tier 2 capital for corporate credit unions could include subordinated term debt because U.S. low-income credit unions count subordinated debt—in the form of a "secondary capital account"—as regulatory capital, because Canadian credit unions count subordinated debt as regulatory capital, and because U.S. federal banking regulators and the Basel Committee on Banking Supervision also consider subordinated debt to be Tier 2 capital.[4]

2. Require PIC Investments for Access to Corporate Services and Lengthen MCS

CUNA believes that natural-person credit unions should make meaningful PIC investments in a corporate in order to use that corporate credit union's services, that the callable period of member capital shares (MCS) should be extended to five years from three years, and that corporate credit unions should be permitted to write down called MCS over five years rather than two.

In general, a natural person credit union's required PIC investment in a corporate credit union should be calculated based on the investing credit union's asset size, and its required MCS balance should be based upon its usage of the corporate credit union's services.

Requiring natural person credit unions to contribute perpetual or 20-year-callable PIC to their corporate and extending the callablility and write-down periods for MCS will strengthen the corporate credit unions' capital positions. In addition, required PIC subscriptions by a corporate credit union's natural person credit unions members would give all users of a corporate credit union's services an increased incentive to monitor their corporate credit union's management and business activities.

CUNA also believes that NCUA should consider making natural person credit unions' PIC investments transferable from one corporate to another, so long as the PIC of state-chartered corporate credit unions would not be considered "capital stock" within the meaning of 26 U.S.C. § 501(c)(14)(A). CUNA believes that transferable PIC would not likely qualify as "capital stock" so long as it is clearly designated as a form of deposit.

3. Risk-Based Capital

If NCUA restricts corporate credit union business and investment in the manner suggested by CUNA, above, risk-based capital requirements for the corporate credit unions would likely not be necessary. However, if such investments are not restricted, then risk-based capital for corporate credit unions engaging in those activities is essential.

If the Basel II risk-based capital rules developed by the Federal Reserve Board, the Office of the Comptroller of the Currency, the Office of Thrift Supervision, and the FDIC applied to corporate credit unions,[5] a corporate credit union that is invested solely in U.S. Treasury securities and other highly-rated fixed-income investments[6] would have an 8 percent risk-based capital ratio requirement that would generally be lower than the amount of capital required by a 4 percent net worth ratio.

Stated another way, risk-based capital requirements for corporate credit unions would generally be irrelevant—if corporate credit unions were subject to a minimum 4 percent net worth ratio and a minimum 8 percent risk-based capital ratio—until a corporate made significant investments in assets in the Basel II 50 percent risk category or the 100 percent or 150 percent risk-weight categories.

Most potential corporate credit union investments would be placed in the 50 percent (or a higher) risk-weight category if they are rated below AA-.

4. Reserves for Payment and Settlement Risk

CUNA believes that corporate credit unions should hold sufficient capital to be insulated from operational risk arising from payment and settlement activities, possibly including a capital charge deducted from Tier 1 capital to establish appropriate reserves for payment and settlement risk.

Under the Basel II standardized approach to controlling for payment and settlement operational risk, a corporate credit union's payments and settlement risk capital charge would be 18 percent of the three-year average of the corporate credit union's annual gross income from payment and settlement activities.

CUNA believes that this reserve for payment and settlement risk should be deducted from Tier 1 capital but should be included in Tier 2 capital (possibly subject to a percentage of assets limitation, such as 1% of assets) because, under Basel II rules, this reserve would qualify as Tier 2 capital. This reserve qualifies under Basel II as Tier 2 capital because it is a general reserve that does not reflect a known loss or deterioration in a particular asset, and would be available to meet unidentified losses that may subsequently arise.

H. Corporate Credit Union Governance

CUNA believes that the boards of directors of corporate credit unions should generally consist of representatives of their member natural person credit unions, but that a corporate credit union should have the option of having up to 20 percent of its board consist of non-member directors if its members so choose.

CUNA wishes to note that most current corporate credit union directors are "outside directors" or "independent directors" within the common definitions of those terms, since they are not officers of the corporate credit union and, as individuals, have no direct financial interest in the corporate.[7] These directors are typically representatives of the corporate credit unions' member natural person credit unions, none of which are individually able to exert control over a corporate because credit unions' one-member-one-vote voting structure prevents the concentration of voting power in the hands of a few. CUNA believes, therefore, that comparisons between the governance of corporate credit unions and that of for-profit, stock corporations with significant numbers of "inside directors"—i.e. those who are also officers of the corporation and/or who represent the interests of controlling stockholders—are inapt.

Outside directors "are considered important because they are presumed to bring unbiased opinions to major corporate decisions and also can contribute diverse experience to the decision-making process."[8] CUNA believes that the outside directors representing the interests of corporate credit unions' member natural person credit unions currently serving on corporate credit unions' boards already bring unbiased opinions to major corporate decisions. CUNA does not believe that corporate credit unions should be required to have outside, non-member directors because most current corporate directors already qualify as "outside directors" and because non-members may have interests that do not align with those of the corporate, or with the interests of credit unions generally.

CUNA believes, however, that corporate credit unions should be permitted the option to have non-member directors who can contribute diverse experience to a corporate credit union's board, if the corporate credit union's member natural person credit unions so choose. A corporate should be permitted to have up to 20 percent of its board be composed of non-members and also be permitted to offer a non-member director a reasonable director's fee comparable to that paid by federally-insured depository institutions of similar asset size, so long as the amount of this fee and any other director compensation is disclosed to the corporate credit union's members. The NCUA Board has authority under section 120(a) of the Federal Credit Union Act to authorize a corporate to have non-member outside directors and to pay those non-member directors a reasonable fee.

I. National Fields of Membership

CUNA believes that the small number of corporate credit unions that operate in the future should continue to have national fields of membership. Without overlapping fields of membership, there would be no competition among corporate credit unions, and therefore, no need to have more than one. CUNA understands that competition among corporate credit unions may have in the past contributed to thinly capitalized institutions, operating on very low margins, taking significant investment risks. However, with sufficient capital requirements and with investments restricted to only those necessary to perform short-term investing and liquidity for credit unions, CUNA believes that competition among corporate credit unions would provide for better service to credit unions in a context of full safety and soundness

III. Conclusion

Thank you for the opportunity to comment on the ANPR regarding the structure and operations of corporate credit unions. The issues raised in the ANPR are critical for all credit unions, and changes to the current corporate credit union structure, as outlined above, are imperative to ensure the continued vitality of both corporate and natural person credit unions.

The entire credit union system is now in the process of absorbing the recent losses associated with corporate credit union investments. Although these losses will never be fully recovered, we strongly believe that adopting the principles and recommendations outlined in this letter will demonstrate the resiliency of the credit union system while helping to help ensure the unfortunate events involving the corporate credit unions are never, ever repeated.

As stated above, CUNA supports NCUA's efforts to help spread out credit unions' costs associated with the Corporate Credit Union Stabilization Plan, including the proposed legislation, and to address related issues. We hope NCUA will work with us to:

- Seek statutory authority for the CLF to provide liquidity directly to corporate credit unions;
- Achieve higher statutory borrower authority for the agency beyond current proposals, to the extent such an effort does not jeopardize the success of any other aspect of the legislations;
- Reassure credit unions it plans to hold asset-backed securities of the two conserved corporate credit unions until maturity; and
- Help clarify remaining accounting issues concerning the reporting of impaired capital in corporate credit unions and the write-down of the NCUSIF deposit.

We also welcome NCUA's announcement that a separate review of the securities of U.S. Central and WesCorp has been undertaken, and that the agency will make critical information from the PIMCO available to the credit union system. We look forward to reviewing the data.

We also recognize that the restructuring of the corporate credit union system will continue to be a difficult process. CUNA and the CCUTF will be available throughout this process to meet with NCUA to work through these very complex issues. Meanwhile, please do not hesitate to contact us at (202) 638-5777 if you have any questions about our comments.

Sincerely,

Daniel A. Mica
President and CEO

Terry West
President/CEO of VyStar CU
and CUNA Corporate Credit Union Task Force Chairman

[1] In addition to spreading out the insurance costs, CUNA has urged NCUA to pursue other means to mitigate credit unions' costs associated with the Corporate Stabilization Program, including funds from the Treasury's TARP, amendments to the FCU Act to allow the CLF to provide loans and capital to corporate credit unions, and options consistent with accounting rules that allow the agency to deviate from GAAP in recognizing its own costs to the NCUSIF.

[2] The 1% deposit is required to be replenished in the year the NCUSIF incurs an impairment that would reduce the Fund balance to below 1%, under the Federal Credit Union Act. However, for the premium costs which fund the .30% balance in the Fund, NCUA has authority under the FCUA to spread those costs out over time. 12 U.S.C. §§ 1782(c)(1)(A), (c)(2).

[3] Members of the Task Force are Terry West, chair, Robert Allen, Dale Dalbey, Tom Gaines, Frank Michael, David Rhamy, and Jane Watkins; Kris Mecham, Tom Dorety , and Harriet May serve as ex officio members.

[4] See, e.g., 12 C.F.R. Appendix A to part 325.

[5] See, e.g., Risk-Based Capital Guidelines; Capital Adequacy Guidelines: Standardized Framework, 73 Fed. Reg. 43982 (proposed July 29, 2008). FDIC-insured depository institutions are subject to a 3 percent absolute leverage ratio on Tier 1 capital and a risk-based capital ratio of 8 percent. See 12 C.F.R. § 325.3; see also, e.g., 12 C.F.R. §§ 3.6, Appendix A to 12 C.F.R. pt. 3 (national banks).

[6] I.e., generally AAA to AA- rated investments. These investments are typically assigned a risk-weighting of 20 percent, meaning that their value for risk-based capital calculation purposes is discounted to 20 percent of face value. See, e.g., Risk-Based Capital Guidelines; Capital Adequacy Guidelines: Standardized Framework, 73 Fed. Reg. 43982, 43991-98 (proposed July 29, 2008).

[7] E.g., "Outside Director," John Downes & Jordan Elliot Goodman, Dictionary of Finance and Investment Terms (Barron's, 7th ed. 2006) ("[A] member of a company's board of directors who is not an employee of the company."); id. at "Independent Director" ("Independent Director: same as Outside Director"); Black's Law Dictionary 473 (7th ed. 1999) ("A non-employee director with little or no direct interest in the corporation.").

[8] "Outside Director", Dictionary of Finance and Investment Terms.